

Message Text

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C O N F I D E N T I A L STATE 197441

E.O. 11652:GDS

TAGS: EFIN

SUBJECT: EPC'S WORKING PARTY THREE MEETING, JULY 19-20,

1976

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REF: (A) CPE/WP3 (76)9, (B) CPE/WP3 (76)10, (C) CPE/WP3

(76) 11, (D) CPE/WP3 (76)12, (E) CPE/TWP (76)14

SUMMARY:ITALIAN STATEMENTS AT WP-3 INDICATED THAT ITALY'S

GROWTH THIS YEAR WILL BE SOMEWHAT STRONGER THAN FORESEEN BY OECD SECRETARIAT AND THAT THE BALANCE OF PAYMENTS CURRENT ACCOUNT DEFICIT CONSEQUENTLY WILL BE LARGER. CHAIRMAN EMMINGER, IN SUMMARIZING, NOTED THAT ITALIAN MONETARY POLICY MUST BE GEARED TO COPING WITH THE LIQUIDITY INCREASE WHEN THE EXTENDED PRIOR DEPOSIT SCHEME ON IMPORTS COMES OFF IN EARLY NOVEMBER; THAT IT IS ESSENTIAL THAT SUBSTANTIAL PROGRESS MUST BE MADE TO REDUCE BUDGET DEFICITS; AND THAT IT IS IMPORTANT TO MODIFY WAGE INDEXATION IN ORDER TO BREAK THE INFLATIONARY SPIRAL. WP-3 WELCOMED PROJECTED SLOWDOWN IN ECONOMIC RATE OF EXPANSION IN OECD AREA IN SECOND HALF OF THIS YEAR AS AN APPROPRIATE "NORMALIZATION" WHICH WOULD HELP AVOID REKINDLING INFLATIONARY PRESSURES OF 1973/74 AND INSURE SUSTAINABILITY OF GROWTH. WP-3 REVIEWED BRIEFLY AN ANALYSIS OF FOOD AND AGRICULTURAL PRICE DEVELOPMENTS PREPARED BY OECD AGRICULTURAL DIRECTORATE AND WAS REASSURED THAT THE SITUATION APPEARED TO BE FUNDAMENTALLY DIFFERENT FROM THAT OF 1973/74. THE GROWING COLLECTIVE DEFICIT ON CURRENT ACCOUNT OF THE OECD AREA WAS NOTED, INCLUDING THE POTENTIAL FINANCING PROBLEMS OF SOME OF THE SMALLER MEMBERS. THE J-CURVE EFFECTS OF DEVALUATION ON THE CURRENT ACCOUNTS OF THE U.K. AND ITALY APPEAR TO HAVE BEEN MODERATED BY A RAPID ADJUSTMENT OF EXPORT PRICES AND BY PARTIAL ABSORPTION OF THE DEVALUATION BY FOREIGN SUPPLIERS. DISCUSSION OF FOREIGN EXCHANGE DEVELOPMENTS CENTERED ON THE RECENT PRESSURES ON THE FRENCH FRANC. THE FRENCH REP (DE LAROSIERE) ACKNOWLEDGED THAT, ALTHOUGH THE MOVE HAD BEEN TRIGGERED BY PSYCHOLOGICAL FACTORS, THERE WERE UNDERLYING ECONOMIC DEVELOPMENTS WHICH VALIDATED A DECLINE. HE EXPRESSED CONSIDERABLE CONFIDENCE THAT THE RATE WOULD STABILIZE SATISFACTORILY. WP-3 TOOK NOTE OF THE RELATIVE STABILITY IN THE DEUTSCHEMARK-DOLLAR EXCHANGE RATE DESPITE LITTLE INTERVENTION, COMPARED WITH THE FLUCTUATIONS IN RATES BETWEEN OTHER CURRENCIES DESPITE CONSIDERABLE INTERVENTION ACTIVITY. THE LARGER COUNTRIES (U.S., F.R.G. AND JAPAN) INDICATED THAT THEY DID NOT FORESEE ANY MAJOR

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INCREASE IN INTEREST RATES, DESPITE THE RECENT BOTTOMING OUT IN RATES. IN ITS FUTURE WORK, WP-3 ACCEPTED THE U.S. SUGGESTION THAT MORE ATTENTION SHOULD BE GIVEN TO THE ROLE OF INCOME EFFECTS ON THE BALANCE OF PAYMENTS ADJUSTMENT PROCESS. NEXT FULL MEETING IN DECEMBER WILL FOCUS ON A DISCUSSION OF INTERNATIONAL LIQUIDITY. END SUMMARY.

I. GROWTH, PRICES AND CURRENT ACCOUNT BALANCES

THE U.S. (UNDER SECRETARY YEO) INDICATED THAT SECOND QUARTER GNP INCREASE WOULD BE SUBSTANTIALLY LOWER THAN IN THE FIRST QUARTER BUT THAT THIS UNDERSTATED THE UNDERLYING GROWTH TREND. RATE OF EXPANSION WOULD BE SLOWER THAN IN 1966 BECAUSE OF CAPACITY LIMITATIONS. PROFIT MARGINS HAD

BEEN RECOVERING, WHICH WAS ESSENTIAL TO SPUR INVESTMENT AND REDUCE UNEMPLOYMENT. SLOW INCREASE IN CAPACITY OVER PAST 8 YEARS REFLECTS ANEMIC PROFIT PERFORMANCE. HE SAID AGRICULTURAL EXPORTS HAD BEEN A LITTLE HIGHER THAN ANTICIPATED, WHILE PETROLEUM IMPORTS HAD BEEN GREATER DUE TO THE FASTER-THAN-ANTICIPATED PACE OF INDUSTRIAL PRODUCTION. IN FIRST HALF 1977, U.S. CURRENT ACCOUNT DEFICIT MIGHT BE SLIGHTLY SMALLER THAN THE SECRETARIAT'S ESTIMATE OF 6 BILLION DOLS. ANNUAL RATE.

THE FRENCH REP (BAQUIAST) EXPECTED A 5.5 PERCENT INCREASE OF GDP IN 1976 (VERSUS SECRETARIAT'S 6 1/4), WITH ALSO A SMOOTHER GROWTH PATH THAN PROJECTED BY SECRETARIAT. ALTHOUGH INFLATION RATE WOULD BE 11 IN 1976, HE EXPECTED A 9 1/2 PERCENT RATE IN THE FIRST HALF OF 1977. HE DESCRIBED THE EFFECTS OF THE DROUGHT AS SERIOUS AND EX-

PECTED IT COULD HAVE A NEGATIVE EFFECT ON THE TRADE BALANCE OF UP TO 1 BILLION DOLS. (2-3 BILLION FRENCH FRANCS DUE TO LOWER NET AGRICULTURAL SURPLUS AND 1-2 BILLION FRENCH FRANCS DUE TO HIGHER ENERGY IMPORTS-DUE HYDROELECTRIC SHORTFALLS). HE THEREFORE FORESAW A POSSIBLE CURRENT ACCOUNT DEFICIT IN 1976 OF 3-4 BILLION DOLS. ("15-20 BILLION FRENCH FRANCS") INSTEAD OF THE 2 3/4 BILLION DOLS. DEFICIT FORECAST BY THE SECRETARIAT. (THE FRENCH FORECAST EXCLUDED ANY IMPACT OF RECENT CHANGES IN FRENCH FRANC). HE ALSO DIFFERED WITH THE SECRETARIAT'S PROFILE OF THE CURRENT CONFIDENTIAL

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BALANCE, STATING THAT THE OFFICIAL OBJECTIVE THREE-FOUR YEARS AFTER THE OIL CRISIS WAS NOT TO HAVE A DETERIORATING TREND IN 1977. IN FACT, FORECAST FOR FIRST HALF 1977 WAS FOR A SMALLER DEFICIT THAN THAT OF 1976.

THE ITALIAN REP (PALUMBO) NOTED THAT ITALY IN LAST FEW DAYS HAD APPROACHED EEC AND IMF FOR 3-MONTH PROLONGATION OF THE PRIOR DEPOSIT SCHEME. HE SAID THAT THERE HAD BEEN A STRONG RECOVERY OF DOMESTIC OUTPUT IN FIRST HALF OF 1976, PRIMARILY IN CONSUMPTION AND STOCK BUILDING. THE DECLINE IN FIXED INVESTMENT STOPPED IN THE FOURTH QUARTER OF 1975. INDUSTRIAL PRODUCTION HAD INCREASED 16 PERCENT (ANNUAL RATE) IN THE FIRST SIX MONTHS OF 1976. REAL GDP INCREASED 7.8 PERCENT (ANNUAL RATE) BETWEEN THIRD QUARTER OF 1975 AND SECOND QUARTER OF 1976. THIS WOULD SLOW DOWN, HE SAID, IN THE SECOND HALF BECAUSE OF RESTRICTIVE MONETARY POLICY AND AN END TO THE PERIOD OF STOCK BUILDING. THE CONSUMER PRICE INCREASE HAD BEEN VERY LOW IN JUNE BUT HE DID NOT EXPECT THIS TO CONTINUE.

PALUMBO SAID THAT OVERALL CREDIT EXPANSION WOULD INCREASE ONLY LITTLE MORE THAN THE 16 PERCENT GROWTH LIMIT AGREED UPON WITH THE EC. DURING FIRST FIVE MONTHS OF 1976

CREDIT EXTENDED TO THE TREASURY REMAINED WITHIN AGREED LIMITS, WHILE CREDIT EXTENDED TO THE PRIVATE SECTOR ROSE BY 7 PERCENT. M2, HOWEVER, INCREASED BY 25 PERCENT. THE FAST GROWTH OF M2 WAS IN PART EXPLAINED BY THE TENDENCY OF INVESTORS TO SHIFT INTO BANK DEPOSITS AT TIMES OF RISING INTEREST RATES. MONETARY BASE ALSO HAD BEEN INCREASING FASTER THAN EXPECTED AND WELL IN EXCESS OF AMOUNTS CONSISTENT WITH INTERNATIONAL COMMITMENTS IN THE MONETARY AREA. THIS RESULTED IN PART FROM THE FACT THAT BANKS WERE REFRAINING FROM INCREASING THEIR HOLDINGS OF TREASURY BILLS AND WERE LENDING TO IMPORTERS TO HELP MEET THEIR REQUIREMENTS UNDER THE IMPORT DEPOSIT SCHEME. THE MORE RAPID THAN EXPECTED INCREASE IN GROWTH OF GDP WAS AN ADDED FACTOR.

IZZO FROM ITALIAN BUDGET MINISTRY ADDED THAT GDP WAS EXPECTED TO DECLINE AT 1 - 1.5 PERCENT RATE IN SECOND HALF.

DEPOSIT SCHEME HAD REACHED MAXIMUM EFFECT AND WOULD FLATTEN
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OUT FROM NOW ON. HE SAID 2.5 - 2.8 BILLION LIRA HAD BEEN ABSORBED BETWEEN MAY 6 AND JULY 15. ROUGHLY 45 PERCENT OF THIS AMOUNT WAS SUPPLIED BY NON-RESIDENTS. HE EXPECTED CURRENT ACCOUNT DEFICIT IN THE SECOND HALF TO BE AT 2.2 - 2.5 BILLION DOLS. ANNUAL RATE IN CONTRAST WITH SECRETARIAT'S ESTIMATED RATE OF 500 MILLION DOLS. HE STATED THAT OBJECTIVE OF POLICY WAS TO REDUCE PUBLIC SECTOR'S NET BORROWING FOR CURRENT EXPENDITURES BY 1 - 1.5 PERCENT OF GDP PER ANNUM OVER THE NEXT THREE YEARS IN ORDER TO REDUCE IT TO ZERO. ANOTHER AIM WAS TO RESTRICT THE INCREASE IN UNIT LABOR COSTS TO NO MORE THAN THAT IN OTHER COUNTRIES. (EMMINGER QUESTIONED SUFFICIENCY OF THIS LATTER OBJECTIVE IN VIEW OF NUMBER OF YEARS ECONOMY HAS BEEN "LIVING BEYOND ITS MEANS.")

IN REPLY TO CONCERN OF EMMINGER THAT GROWTH WAS LESS BASED ON EXPORTS THAN IT SHOULD BE, MAGNIFICO SAID THAT GROWTH WAS MORE EXPORT-LED THAN INDICATED BY NOMINAL TRADE FIGURES. IN THE FIRST HALF, EXPORT VOLUME HAD INCREASED BY 4.7 PERCENT COMPARED WITH AN INCREASE OF DOMESTIC DEMAND OF 3.0 PERCENT. FOR THE YEAR AS A WHOLE EXPORTS WERE EXPECTED TO RISE BY 10.3 PERCENT IN VOLUME TERMS. IN NOMINAL TERMS, THIS WOULD LEAD TO A CONSIDERABLE IMPROVEMENT IN THE TRADE BALANCE, BECAUSE EXPORT PRICES WERE ADJUSTING VERY QUICKLY TO THE DEVALUATION. ON THE OTHER HAND, IMPORT PRICES WERE RISING LESS.

IN HIS SUMMARY, EMMINGER DESCRIBED THE ITALIAN SITUATION AS FOLLOWS: THE MONETARY SQUEEZE AND DEPOSIT SCHEME COULD ONLY BE REGARDED AS A HOLDING ACTION, PENDING MORE BASIC POLICY MEASURES. MONETARY POLICY SHOULD BE GEARED TO COUNTERING THE LIQUIDITY IMPACT FROM THE TERMINATION OF THE

IMPORT DEPOSIT SCHEME. OTHER STEPS SHOULD BE TAKEN TO PREVENT CAPITAL FLIGHT. UNDUE RELIANCE ON MONETARY STRINGENCY WOULD DISCOURAGE THE REVIVAL OF INDUSTRY. THE BUDGETARY DEFICIT WAS DISTURBINGLY HIGH. IT COULD ONLY BE PARTLY EXPLAINED BY CYCLICAL FACTORS. A LARGE PART OF IT WAS A QUESTION OF BUDGET CONTROL OVER BOTH EXPENDITURES AND RECEIPTS. ONE-THIRD OF THE CURRENT BUDGET WAS BEING FINANCED THROUGH MONETARY SOURCES. THEREFORE, PROGRESS SHOULD BE MADE IN: (A) STRENGTHENING BUDGETARY PROCEDURES, (B) RECONFIDENTIAL

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DUCING PUBLIC SECTOR BORROWING REQUIREMENTS FOR 1977 AND FUTURE YEARS, ESPECIALLY ON THE CURRENT ACCOUNT, AND (C) TAKING APPROPRIATE STEPS TO FINANCE THE DEFICIT THROUGH NON-MONETARY MEANS. THERE WAS AN IMPORTANT NEED TO MODIFY THE SYSTEM OF WAGE INDEXATION AND SLOW THE GROWTH OF MONEY WAGES. HE AGREED WITH ITALIANS THERE WAS ALSO NEED TO INCREASE PRODUCTIVE INVESTMENT.

THE JAPANESE REP (MATSUKAWA) SAID THAT IN JAPAN SLOW GROWTH IN LAST PART OF 1975 HAD BEEN REVERSED IN FIRST QUARTER 1976. HE DESCRIBED THE RECOVERY AS "SOLIDLY BASED." HE WAS LESS OPTIMISTIC ABOUT PRICES BECAUSE OF THE PICK-UP IN DOMESTIC DEMAND, NEED TO ADJUST SOME GOVERNMENT CONTROLLED PRICES AND THE LIKELY DEVELOPMENTS IN COMMODITY PRICES. THE JAPANESE GOVERNMENT HAD NOT REVISED ITS OFFICIAL FORECAST, MADE LAST FALL, OF A BALANCE OR SMALL DEFICIT ON CURRENT ACCOUNT IN 1976. A PRIVATE FORECAST WOULD SOON BE ISSUED WHICH MIGHT SHOW SOMEWHAT LESS DIVERGENCE FROM THE SECRETARIAT'S FORECAST OF A LARGE CURRENT ACCOUNT SURPLUS (3.5-4.0 BILLION DOLS.) IN 1976. MR. MATSUKAWA EXPECTED SOME SLOWDOWN IN THE GROWTH OF EXPORTS, A SURGE IN IMPORTS REFLECTING THE INCREASE IN DOMESTIC DEMAND, AND HIGHER PRICES FOR IMPORTED COMMODITIES.

THE U.K. REP (MCMAHON) BROADLY AGREED WITH THE SECRETARIAT'S OUTLOOK FOR HIS COUNTRY. HE SAW OUTPUT PICKING UP A LITTLE FASTER IN THE SECOND HALF OF 1976 THAN FORECAST BY THE SECRETARIAT. HE HOPED THAT THE PRESENT EXPORT-LED GROWTH WOULD BE JOINED BY INVESTMENT-SPURRED GROWTH IN 1977. TWO PERCENT INCREASE IN GDP IN 1976 IMPLIED A CONTINUED INCREASE IN UNEMPLOYMENT, WHICH WAS A MAJOR POLICY PROBLEM. INFLATION RATE, ON THE OTHER HAND, HAD BEEN HALVED SINCE LAST SUMMER. HE SAID THE EXCHANGE RATE DEPRECIATION HAD PUSHED THE UNITED KINGDOM SOMEWHAT OFF ITS PLANNED ANTI-INFLATION TARGET. SINGLE DIGIT INFLATION WOULD NOT NOW OCCUR UNTIL EARLY 1977. THE TERMS OF TRADE, HOWEVER, HAD DETERIORATED BY ONLY 1 1/2 PERCENT BETWEEN THE FIRST QUARTER AND THE SECOND QUARTER, LESS THAN EXPECTED. EXPORT PRICES WERE RESPONDING MORE QUICKLY TO THE DECLINE IN THE POUND, REFLECTING CHANGES IN EXPORT PRICING PRACTICES (I.E., INVOICING IN FOREIGN CURRENCIES) WHILE IMPORT PRI-

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CES WERE RISING LESS THEN THE DEVALUATION. THERE WAS THUS A FLATTENING OUT OF THE USUAL J-CURVE EFFECT. HE SUMMARIZED THE BRITISH SITUATION AS ONE OF "SLOW AND DOGGED IMPROVEMENT."

MCPAHON SAID THAT NORTH SEA GAS AND OIL WOULD PROVIDE A NET PLUS 100 MILLION POUNDS TO THE BRITISH CURRENT BALANCE OF PAYMENTS THIS YEAR, CONTRASTED WITH A NEGATIVE 600 MILLION POUNDS IN 1975. BY 1980, IT WAS EXPECTED THAT THE NORTH SEA WOULD PROVIDE A NET SURPLUS OF 5-6 PERCENT OF GNP TO THE CURRENT BALANCE. CONCERNING THE SECRETARIAT'S CURRENT ACCOUNT FORECAST FOR FIRST HALF 1977 (2 1/2 BILLION DOLLAR DEFICIT, ANNUAL RATE), HE DID NOT SEE THE IMPROVEMENT IMPLICIT IN THE SECRETARIAT'S FORECAST, BUT INSTEAD A ROUGHLY FLAT TREND. IN REPLY TO A QUESTION, HE STATED THAT THE INCREASE IN GOVERNMENT REVENUES STEMMING FROM OIL

PROCEEDS WOULD NOT LEAD TO AN UNCONTROLLABLE INCREASE IN PUBLIC EXPENDITURES.

THE GERMAN REP (POHL) HAD NO DIFFICULTIES WITH SECRETARIAT'S ANALYSIS. HE SAID THAT GROWTH IN GERMAN GNP DURING THE FIRST HALF OF 1976 HAD BEEN 10 PERCENT (ANNUAL RATE) BUT WOULD SLOW DOWN SOME IN THE SECOND HALF FOR A YEARLY RATE INCREASE OF 6 PERCENT (VERSUS SECRETARIAT'S 5.5). HE DESCRIBED THE SLOWDOWN AS A PROCESS OF "NORMALIZATION". ON THE OTHER HAND, HE SAW POSITIVE INCENTIVES TO FURTHER GROWTH, INCLUDING THE WORLDWIDE RECOVERY IN DEMAND. BUT THERE WERE ALSO SOME UNCERTAINTIES. INVESTMENT DEMAND WAS STILL RATHER WEAK. PRIVATE CONSUMPTION WAS ONLY MODERATE. UNEMPLOYMENT WAS TOO HIGH. PRICE PERFORMANCE WAS GOOD, WITH THE ONLY MAJOR CONCERN BEING IMPORT PRICES. ON THE BALANCE OF PAYMENTS, POHL DESCRIBED STRONG INCREASE IN IMPORTS (21 PERCENT INCREASE, JAN.-MAY 1976 OVER JAN.-MAY 1975) COMPARED WITH EXPORTS (14 PERCENT INCREASE ON SAME BASIS). HE EXPECTED 1976 TRADE SURPLUS OF \$14 BILLION AND CURRENT ACCOUNT SURPLUS OF \$2.5-3.0 BILLION (LITTLE HIGHER THAN SECRETARIAT'S ESTIMATE). POHL ALSO DID NOT EXPECT THE CURRENT BALANCE (ANNUAL RATE) TO FALL TO ZERO IN FIRST HALF 1977 AS SECRETARIAT FORECAST. HE SAID THERE HAD BEEN SIGNIFICANT EXPORTS OF CAPITAL. SHORT-TERM CAPITAL INFLOWS

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HAD BEEN MOSTLY DUE TO SNAKE INTERVENTION.

THE DUTCH REP(OORT) SAID THAT THE GNP GROWTH RATE FOR THE NETHERLANDS BY THE SECRETARIAT FOR 1976 (4 PERCENT) WAS marginally TOO HIGH. THE PRICE FORECAST OF 8-3/4 PERCENT

WAS IN THE RANGE OF PROBABILITY. HE FORESAW A CURRENT ACCOUNT SURPLUS IN 1976 marginally lower than the surplus figure of \$2.5 billion forecast by the Secretariat. The two major policy problems for the Netherlands, according to Oort, were: (A) lagging economic expansion because of weak investment (related to the large share of labor income in GNP) and (B) continued inflation, with wage increases in the double figures. The Belgian Rep (Jansson) expected 1976 GNP to increase by 3-3/4 percent, prices (GNP deflator) to increase by 9-10 percent and current account balance to be in equilibrium or slight deficit.

The Swedish Rep (Vinde) said GNP was increasing for 1976 in the range of 1.5-2.0 percent (little stronger than forecast by the Secretariat). He thought the current account balance might be a little worse than the \$1 billion deficit forecast by the Secretariat. He hoped that the 1976 price increase (GNP deflator) would be 8-8-1/2 percent instead of the 9-1/2 percent estimated by the Secretariat.

The Swiss Rep (Languetin) said that 1976 growth would be stronger than forecast by Secretariat (1.7 versus 1.0 percent increase). Prices would increase by about 1 percentage point more than the 2 percent forecast by the Secretariat because of the drought. He expected the 1976 surplus on current account to be \$2-3 billion instead of the \$3.5 billion forecast by the Secretariat.

The Canadian Rep (Neufeld) agreed with the Secretariat forecast of 5 percent increase of GNP in 1976, but said that the first half rate was higher than shown by Secretariat because of the inventory turnaround. He agreed with the Secretariat's price forecast (8-3/4 percent increase in the GNP deflator in 1976), but thought it might be even a shade optimistic. Noting that financing was no problem, he did not disagree with the Secretariat's current

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ACCOUNT DEFICIT figure of \$5 billion in 1976, but unlike the Secretariat thought it would be lower in 1977. The major concern of policy was controlling costs and prices.

II. OUTLOOK FOR AGRICULTURAL AND FOOD PRICES

WP-3 had a brief exchange of views on an analysis of the outlook for agricultural and food prices prepared by the OECD Agricultural Directorate (Ref Doc D). The group was encouraged by the paper's conclusion that the overall situation appeared to be fundamentally different from the 1973/74 boom in prices and that although food prices could increase faster than the GNP deflator, there were also some favorable price developments.

III. BALANCE OF PAYMENTS POSITION OF SMALLER OECD ECONOMIES

THE SECRETARIAT (FAY) DESCRIBED DISCUSSIONS AT JULY 8 MEETING OF EPC'S TEMPORARY WORKING PARTY ON THE BALANCE OF PAYMENTS POSITIONS OF THE SMALLER OECD COUNTRIES. FAY SAID THE GENERAL FEELING HAD BEEN THAT NORWAY, AUSTRIA AND SWEDEN HAD NO FINANCING PROBLEMS. AUSTRALIA AND IRELAND HAD SHRINKING DEFICITS WHICH ALSO PRESENTED NO FINANCING PROBLEM. THEREFORE, TWP HAD FOCUSED ON ONLY SEVEN COUNTRIES: DENMARK, FINLAND, GREECE, NEW ZEALAND, PORTUGAL, SPAIN AND TURKEY. THEIR POSITIONS VARIED CONSIDERABLY, BUT FAY NOTED THAT THEY ALL HAD RATES OF INFLATION WHICH WERE ABOVE THE OECD AVERAGE. THE IMF REP TO WP-3 (WHITTOME) OBSERVED THAT OF THESE COUNTRIES ONLY GREECE HAD GONE INTO EVEN ITS FIRST CREDIT TRANCHE AT THE IMF BUT EVEN IF THEY BORROWED UP TO THEIR MAXIMUM FROM THE FUND, THIS WOULD ONLY COVER A SMALL PORTION OF THEIR TOTAL DEFICITS. DISCUSSING WORLD BALANCE OF PAYMENTS PATTERNS WP-3 GENERALLY AGREED WITH U.S. (YEO) VIEW THAT OPEC-INDUCED DEFICIT WAS NOW SHIFTING OUT OF THE NON-OIL LDCS INTO THE OECD AREA TO A GREATER EXTENT THAN EARLIER APPARENT, RAISING QUESTIONS AS TO THE ADEQUACY OF ADJUSTMENT SHOULD MARKET BORROWING BECOME MORE DIFFICULT. WP-3 NOTED THAT THE WP WOULD BE REEXAMINING THE SMALLER OECD COUNTRIES' POSITIONS AT ITS OCTOBER MEETING.

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IV. MONETARY AND FOREIGN EXCHANGE DEVELOPMENTS

THE FRENCH REP (DE LAROSIERE) LED OFF DISCUSSION OF MONETARY AND EXCHANGE RATE DEVELOPMENTS WITH DESCRIPTION OF RECENT DECLINE IN VALUE OF THE FRENCH FRANC TRIGGERED, HE FELT, BY PSYCHOLOGICAL FACTORS. FRENCH PRICE PERFORMANCE HAD IMPROVED OVER THE FIRST HALF OF THE YEAR, BUT THERE HAD BEEN UNDERLYING FACTORS. THE DROUGHT WAS INVOLVED AS WELL AS THE LEVEL OF FOREIGN DEBT ALTHOUGH THERE WAS NO SINGLE PRECISE EXPLANATION FOR THE EXCHANGE RATE PRESSURES. FOR SEVERAL REASONS, HE WAS CALM ABOUT THE SITUATION. NON-RESIDENT FRENCH FRANC ACCOUNTS HAD NOT BEEN BUILT UP AGAIN SINCE THE MARCH OUTFLOW, SO THEY WERE NO MAJOR PROBLEM NOW. EXPORTERS HAD RUN UP AGAINST THEIR 6-MONTH CREDIT LIMITS. THE LIMIT HAD ALSO BEEN REACHED ON 3-MONTH FORWARD EXCHANGE COVER. MONETARY POLICY MEASURES WERE BEGINNING TO BE FELT. M2 EXPANSION WAS DOWN FROM 22 PERCENT TO 13 PERCENT ANNUAL RATE OVER THE JANUARY-MAY PERIOD. THE TRADE BALANCE HAD BEEN IMPROVING, WITH EXPORTS INCREASING FASTER THAN IMPORTS DESPITE THE DOMESTIC ECONOMIC RECOVERY. THE DROUGHT ON THE OTHER HAND WOULD REDUCE THE SURPLUS IN AGRICULTURAL TRADE TO THE 1975 LEVEL. IN RESPONSE TO QUESTIONS ABOUT A "17 PERCENT" INCREASE IN THE FRENCH WAGE RATE DURING THE FIRST

HALF OF 1976, HE REPLIED THAT THE INCREASE WAS MORE ON ORDER OF 15 PERCENT AND THAT 6-7 PERCENT INCREASE IN LABOR PRODUCTIVITY COMBINED WITH THIS WAS NOT INCONSISTENT WITH A CPI INCREASE OF 8-9 PERCENT IN 1976 (VERSUS SECRETARIAT'S 11 PERCENT FORECAST).

THE U.S. REP (YEO) SAID THAT U.S. INTEREST RATES HAD BOTTOMED OUT IN THE EARLY SPRING. RATES HAD RISEN MATERIALLY IN MAY (ALTHOUGH MODERATELY COMPARED WITH THEIR RISE IN 1973-74) BECAUSE OF CORPORATE FINANCIAL BEHAVIOR, MODERATE REDUCTION IN THE SAVINGS RATIO AND A SLIGHT TIGHTENING OF MONETARY POLICY. MARKET EXPECTATIONS HAD BEEN VOLATILE. SINCE EARLY JUNE, THE MARKET HAD GIVEN BACK ONE HALF OF THE SHORT-TERM INTEREST RATE INCREASE, ONE HALF OF THE INTERMEDIATE-RATE INCREASE AND TWO FIFTHS OF THE LONG-TERM RATE INCREASE. HE DID NOT EXPECT A SURGE IN INTEREST RATES SUCH AS OCCURRED IN 1973-74, BECAUSE ECONOMIC POLICY WOULD AVOID IT. U.S. (TRUMAN) CORRECTED SECRETARIAT
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IMPRESSION IN REF DOC (C) THAT FEDERAL OPEN MARKET COMMITTEE IN MAY HAD MADE ITS DECISION BASED TOTALLY

ON INCREASE IN APRIL MONETARY AGGREGATES. HE NOTED THAT THE FOMC TRIES TO TAKE A LONGER TERM VIEW, GEARING THE MONEY SUPPLY TO WHAT IS OR SHOULD BE HAPPENING IN THE DOMESTIC ECONOMY.

JAPANESE REP (MATSUKAWA) SAID THAT RISE IN SHORT-TERM RATES IN JUNE WAS TEMPORARY PHENOMENON, PARTLY SEASONAL, AND WOULD BE REVERSED IN NEAR FUTURE. UK REP (MCMAHON) HOPED THAT U.S. VIEW ABOUT RATES WAS CORRECT, BECAUSE KEEPING UK RATES 5 PERCENTAGE POINTS ABOVE EURORATES HAD PLAYED A LARGE ROLE IN STABILIZING THE POUND. PRESENT UK RATES WERE FELT TO BE ALREADY HIGH ENOUGH AND HE WOULD NOT WANT THEM TO GO HIGHER.

EMMINTER DESCRIBED GERMAN MONETARY POLICY AS BEING ON TARGET. HE FORESAW NO UPTURN IN MEDIUM- AND LONG-TERM RATES. HE NOTED IMPORTANCE OF THE INTEREST RATE DIFFERENTIAL BETWEEN THE U.S. AND GERMANY FOR THE DM/DOLLAR EXCHANGE RATE. IN HIS VIEW, THE FACT THAT THE U.S. AND FRG ECONOMIES WERE GROWING IN PARALLEL AND THAT THEIR INTEREST RATES WERE IN PARALLEL EXPLAINED THE 10-11 MONTHS OF RELATIVELY LITTLE MOVEMENT IN THE DM/\$ EXCHANGE RATE.

THE CANADIAN REP (JUBINVILLE) SAID THAT CANADIAN RATES DID NOT FIT THE GENERAL PATTERN. AFTER RISING IN 1975 THEY HAD NOW ONLY LEVELED OFF. SECRETARIAT PAPER HAD BEEN WRONG IN SAYING THAT MONETARY POLICY HAD ACTIVELY TIGHTENED. THE BANK RATE HAD BEEN CHANGED ONLY IN ORDER TO BRING M1 AND OTHER AGGREGATES BACK ON TRACK WITH THE MONETARY TAR-

GETS. THE PRIORITY OBJECTIVE REMAINED ONE OF GETTING INFLATION UNDER CONTROL.

THE SECRETARIAT (MARRIS) NOTED THAT WP-3 COUNTRIES SEEMED TO BE NEARER TO THE RANGE OF THEIR MONETARY AGGREGATE TARGETS THAN AT THE MAY MEETING AND WAS ENCOURAGED THAT THIS HAD BEEN ACHIEVED WITH ONLY A MODEST RISE IN RATES. HE REMARKED ON THE STATISTICALLY STRIKING SLOWDOWN IN FRENCH MONETARY AGGREGATES AND SAW THIS AS AN ENCOURAGING CONFIDENTIAL

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SIGN.

EMMINGER SUMMARIZED THE SITUATION AS FOLLOWS: MONETARY POLICY REMAINS CAUTIOUSLY EXPANSIONARY WITH THE EXCEPTION OF SOME COUNTRIES WITH EXTREME BALANCE OF PAYMENTS DIFFICULTIES. COUNTRIES WERE LOOKING CLOSER TODAY THAN BEFORE AT THE MONETARY AGGREGATES. THE DM/\$ EXCHANGE RATE HAD BEEN STABLE WITH LITTLE INTERVENTION, WHEREAS OTHER RATES HAD FLUCTUATED CONSIDERABLY DESPITE SUBSTANTIAL INTERVENTION.

V. FUTURE WORK

WP-3 ACCEPTED SUGGESTIONS BY U.S. (YEO) THAT THE GROUP (A) EXAMINE THE ROLE OF INCOME EFFECTS IN THE ADJUSTMENT PROCESS (COMPENSATING FOR THE OVEREMPHASIS THAT HAD BEEN PLACED ON PRICE EFFECTS), (B) AVOID FALLING INTO TRAP THAT SOMEHOW MONETARY POLICY CONTROLS INTEREST RATES FOR MORE THAN THE SHORT TERM AND (C) START ITS ANALYSIS AT A SUBSEQUENT MEETING BY LOOKING AT THE OVERALL WORLD SITUATION AND THEN DISAGGREGATE.

VI. NEXT MEETINGS

THE WP AGREED TO BE PREPARED FOR A BRIEF MEETING OF THOSE MEMBERS ATTENDING THE MANILA MEETINGS OF THE IMF AND IBRD ON OCTOBER 7. THE NEXT REGULAR MEETING OF WP-3 WAS SET FOR DECEMBER 6-7, WITH THE AGENDA TO INCLUDE A FULL SCALE DEBATE ON ALL ASPECTS OF INTERNATIONAL LIQUIDITY. ROBINSON

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<< END OF DOCUMENT >>

Message Attributes

Automatic Decaptioning: X
Capture Date: 15 SEP 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC GROWTH, MEETINGS, ECONOMIC ESTIMATES, BALANCE OF PAYMENTS DEFICITS, ECONOMIC PROGRAMS, CURRENCY CONTROLS
Control Number: n/a
Copy: SINGLE
Draft Date: 09 AUG 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ShawDG
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
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Handling Restrictions: n/a
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Original Handling Restrictions: n/a
Original Previous Classification: n/a
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Previous Handling Restrictions: n/a
Reference: n/a
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Review Authority: ShawDG
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Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EPC'S WORKING PARTY THREE MEETING, JULY 19-20,
TAGS: EFIN, IT
To: OECD PARIS INFO BERN
BONN
BRUSSELS
LONDON
OTTAWA

THE HAGUE
PARIS
ROME
STOCKHOLM
TOKYO
EC BRUSSELS

Type: TE

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